**Before the
Federal Communications Commission
Washington, D.C. 20554**

In the Matter of	)	
	)	
The Commission's Cable Horizontal and Vertical Ownership Limits	)	MM Docket No. 92-264
	)	

SECOND FURTHER NOTICE OF PROPOSED RULEMAKING

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By the Commission: Commissioners Copps and Adelstein issuing a joint statement.

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I. INTRODUCTION

1. The Cable Television Consumer Protection and Competition Act of 1992 amended the Communications Act of 1934 to provide increased consumer protection and to promote increased competition in the cable television and related markets.[1] Among other things, the 1992 Act added behavioral rules for cable carriage of broadcast signals and retransmission consent;[2] rate regulation;[3] program access obligations with respect to satellite-delivered cable programming;[4] and structural rules intended to address the consequences of increased horizontal concentration and vertical integration in the cable industry.[5] Section 613(f) directed the Commission to conduct proceedings to establish reasonable limits on the number of subscribers a cable operator may serve (horizontal limit), and the number of channels a cable operator may devote to its affiliated programming networks (vertical, or channel occupancy, limit).[6] A principal goal of this comprehensive program was to foster a diverse, robust, and competitive market in the acquisition and delivery of multichannel video programming.[7] Congress intended the structural ownership limits mandated by Section 613(f) to ensure that cable operators did not use their dominant position in the multichannel video distribution (MVPD)[8] market, acting unilaterally or jointly, to unfairly impede the flow of video programming to consumers.[9] At the same time, Congress recognized that multiple system ownership could provide benefits to consumers by allowing efficiencies in the administration, distribution and procurement of programming, and by providing capital and a ready subscriber base to promote the introduction of new programming services.[10] The matters before the Commission in this proceeding stem directly from efforts begun in 1992 to implement Congress' mandate to balance these competing interests by adopting reasonable cable ownership limits and attribution benchmarks.[11]

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[1] Cable Television Consumer Protection and Competition Act of 1992, Pub. L. No. 102-385, 106 Stat. 1460 (1992 Act); H. Rep. No. 628, 102d Cong., 2d Sess. 1 (1992) (*House Report*); Communications Act of 1934, 47 U.S.C. §§ 151, et seq. (Communications Act).

[2] Communications Act §§ 614 and 615, 47 U.S.C. §§ 534 and 535.

[3] *Id.* § 623, 47 U.S.C. § 543.

[4] *Id.* § 628, 47 U.S.C. § 548.

[5] *Id.* § 613(f), 47 U.S.C. § 533(f).

[6] *Id.*

[7] *See* S. Rep. No. 92, 102d Cong., 1st Sess. 1, 18 (1991) (*Senate Report*); *House Report* at 27; *see also* 1992 Act § 2(a)(4), (b)(1)-(5); 47 U.S.C. § 521 (a)(4), (b)(1)-(5).

[8] MVPDs include, but are not limited to, providers of cable, multichannel multipoint distribution, direct broadcast satellite, and television receive-only program distribution services that make "available for purchase by subscribers or customers, multiple channels of video programming." 47 U.S.C. § 522(13).

[9] 47 U.S.C. § 533(f)(2)(A).

[10] *House Report* at 41, 43; *see also Senate Report* at 27, 33.

[11] *See, e.g., Implementation of Section 11(c) of the Cable Television Consumer Protection and Competition Act of 1992 Horizontal Ownership Limits,* 14 FCC Rcd 19098 (1999) (*1999 Cable Ownership Order*); *Implementation of the Cable Television Consumer Protection and Competition Act of 1992*, 14 FCC Rcd 19014 (1999) (*1999 Cable* (continued....)

2. The Commission first established a 30% cable subscriber (horizontal) ownership limit and 40% channel occupancy (vertical) rule in 1993.[12] It found that a 30% horizontal ownership limit on cable households passed "is generally appropriate to prevent the nation's largest MSOs from gaining enhanced leverage from increased horizontal concentration," while at the same time, "ensur[ing] that a majority of MSOs continue to expand and benefit from the economies of scale necessary to encourage investment in new video programming services and the deployment of advanced cable technologies."[13] With respect to the vertical limit, the Commission found that a 40% limit on the number of activated channels that can be occupied by the operator's affiliated video programming services [14] "is appropriate to balance the goals of increasing diversity and reducing the incentive and ability of vertically integrated cable operators to favor their affiliated programming, with the benefits and efficiencies associated with vertical integration."[15] The limit applies only to channel capacity up to 75 channels.[16] The 75-channel maximum reflected the Commission's recognition that expanded channel capacity would reduce the need for channel occupancy limits as a means of encouraging cable operators to carry unaffiliated programming, and that the dynamic state of cable technology required that periodic review of the channel occupancy limit be undertaken.[17] In the *1995 Vertical Reconsideration Order*, the Commission denied

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Attribution Order); *Implementation of 11(c) of the Cable Television Consumer Protection and Competition Act of 1992 Horizontal Ownership Limits*, 13 FCC Rcd 14462 (1998) (*1998 Horizontal Reconsideration Order*); *Implementation of the Cable Television Consumer Protection and Competition Act of 1992, Review of the Cable Attribution Rules*, 13 FCC Rcd 12990 (1998); *Regulations Governing Attribution of Broadcast and Cable/MDS Interests, Regulations and Policies Affecting Investment in the Broadcast Industry and Reexamination of the Commission's Cross-Interest Policy*, 11 FCC Rcd 19895 (1996); *Implementation of Sections 11 and 13 of the Cable Television Consumer Protection and Competition Act of 1992*, 10 FCC Rcd 7364 (*1995 Vertical Reconsideration Order*); *Implementation of Sections 11 and 13 of the Cable Television Consumer Protection and Competition Act of 1992, Horizontal and Vertical Ownership Limits, Cross-Ownership Limitations, and Anti-trafficking Provisions*, 8 FCC Rcd 8565 (1993) (*1993 Second Report and Order*); *Implementation of Sections 11 and 13 of the Cable Television Consumer Protection and Competition Act of 1992, Horizontal and Vertical Ownership Limits*, 8 FCC Rcd 210 (1992).

[12] *1993 Second Report and Order*, 8 FCC Rcd at 8567 ¶¶ 3-4.

[13] *Id.* at 8577 ¶ 25.

[14] *Id.* at 8601 ¶¶ 83-84. The "up to" 75 video channels limit was based on the technological capacity of the average cable system in 1993, which generally limited the number of channels available for distribution of video programming, absent advancements such as signal compression or "fiber to the block," to approximately 75 channels. *Id.* at 8601 ¶ 84 & n. 106. The Commission further recognized that the need for a vertical limit would likely decrease as channel capacity increased, so it capped the limit for larger systems of greater than 75 channels.

[15] *Id.* at 8594 ¶ 68.

[16] For a system with 75 or fewer channels, the limit is 40% of actual activated channel capacity; 60% of activated channel capacity must be reserved for unaffiliated programming, *i.e.*, 45 channels for a 75 channel system. For systems with 75 or more channels, the limit is applied only to 75 channels, meaning, in effect, that 45 channels on such systems must be reserved for unaffiliated programming (60% of 75). As a result, the limit for larger systems is effectively higher when expressed as a percentage of system capacity, than the limit for systems with 75 channels or fewer.

[17] *Id.* at n.86 (measurement of the channel occupancy rule to be done on a per channel basis using the traditional 6 MHz channel definition; periodic review necessary in light of fact that it may soon be common for cable operators to provide several channels using a single 6 MHz bandwidth segment).

two petitions for reconsideration and reaffirmed its decision regarding the 40% channel occupancy limit.[18]

3. To better reflect changed market conditions and allow for organic growth in subscribership, in the *1999 Cable Ownership Order* the Commission revised the 30% horizontal limit to permit a cable operator to reach 30% of all MVPD subscribers, rather than solely cable subscribers.[19] As the Commission observed, this was equivalent to establishing a 36.7% cable subscriber limit.[20] This limit was based on the Commission's determination that cable operators at certain concentration levels, "either by unilateral, independent decisions or by tacit collusion," could effectively prevent programming networks from entering or surviving the marketplace simply by deciding not to carry a particular network, thereby impeding the flow of programming to the consumer.[21] The Commission estimated that a new cable programming network would need access to 40% of the MVPD subscribers nationwide to be viable.[22] A 30% limit, the Commission reasoned, would allow new programming networks access to a 40% "open field" by ensuring the presence of at least four cable operators in the market, and by preventing the two largest cable operators from garnering more than 60% of the market.[23]

4. In proceedings implementing the 1992 Act's broad structural rules, the Commission determined that use of its broadcast attribution standard was appropriate for defining what constitutes a cognizable interest.[24] Specifically, use of the broadcast attribution benchmarks for horizontal cable ownership and vertical channel occupancy limits was considered appropriate, because, like the broadcast ownership rules, the 1992 Act's rules governing cable industry structure were designed to ensure competition and diversity in the video marketplace.[25] The 1993 cable horizontal and vertical ownership

[18] *1995 Vertical Reconsideration Order*, 10 FCC Rcd at 7365 ¶ 3.

[19] *1999 Cable Ownership Order*, 14 FCC Rcd at 19101 ¶ 5.

[20] *Id.* at 19101 ¶ 6.

[21] *Id.* at 19114-16 ¶¶ 38-44.

[22] The 40% "open field" was based on the Commission's findings that in order to be viable, a new programming network needs to access approximately 15-20 million subscribers (20% of the market), and that, even with such access, it has only a 50% chance of actually reaching subscribers given tier packaging and consumer preferences. *See 1999 Cable Ownership Order*, 14 FCC Rcd at 19115-18 ¶¶ 40-51.

[23] *Id.*

[24] *1993 Second Report and Order*, 8 FCC Rcd at 8579-81, ¶¶ 30-35 (horizontal attribution standard), 8590-92 ¶¶ 56-63 (vertical attribution standard). *See also, Implementation of the Cable Television Consumer Protection and Competition Act of 1992, Review of the Commission's Cable Attribution Rules, Notice of Proposed Rulemaking*, 13 FCC Rcd 12990, 991-993 ¶ 2, 4 (1998) (*1998 Cable Attribution NPRM*).

[25] The Commission also observed that the legislative history of the 1992 Act expressly suggested use of the broadcast attribution standard. *1998 Cable Attribution NPRM*, 13 FCC Rcd at 12993 ¶ 4. The "general" cable attribution rules apply to such broad structural limitations as the horizontal ownership limits, 47 C.F.R. § 76.503; channel occupancy limits, 47 C.F.R. § 76.504; cable/SMATV cross-ownership, 47 C.F.R. § 76.501(d); and cable-telco buyout prohibition, 47 C.F.R. § 76.505. In contrast, for those rules implemented under the 1992 Act to deter specific improper practices and also to promote competition and diversity, such as commercial leased access and program access, the Commission adopted additional, stricter cable attribution standards. *See 1998 Cable*
(continued….)

attribution standards mirrored the broadcast attribution rules, and *inter alia*, attributed all corporate voting stock interests of 5% or more and contained an exemption to the voting stock threshold under which a minority corporate shareholder's voting interests were not attributed in cases where a single shareholder owns more than 50% of the outstanding voting stock of the corporation.[26] Both broadcast and cable standards attributed partnership interests, except properly "insulated" limited partnership interests.[27] In 1998, the Commission launched a comprehensive review of the cable attribution rules in light of recent developments in the cable industry together with the Commission's review, in a separate proceeding, of the broadcast attribution rules on which many of the cable attribution rules were based.[28]

5. In the *1999 Cable Attribution Order*, the Commission revised several aspects of its cable attribution rules to track certain changes made to the broadcast attribution rules. In addition, in a departure from the broadcast attribution rules, the *1999 Cable Attribution Order* eliminated the single-majority shareholder exemption to its general cable attribution standard and relaxed one of the limited partner insulation criteria, which, if satisfied, keep a limited partnership interest from being attributed to a limited partner, to permit a broader range of activities performed on behalf of the partnership by a limited partner while still remaining insulated.[29] In general, limited partners cannot be relieved from attribution unless they are not materially involved in the management or operations of the media entity concerned (the "no material involvement" standard). In setting specific guidance as to what kind of insulation is sufficient to exempt a limited partnership interest from attribution, the Commission originally established seven criteria, collectively referred to herein as the "ILP exception," which, if met would make it safe to presume that a limited partner will not be materially involved in the media management and operations of the partnership.[30] The sixth insulation criteria applicable to cable ownership generally barred a limited partner from performing "any services to the partnership relating to its media activities." The Commission narrowed this prohibition to exclude only services performed by the limited partner for the partnership that are materially related to the partnership's *video programming* activities, thus broadening the range of activities that could performed without loss of insulation for the

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Attribution NPRM, 13 FCC Rcd at 12993 ¶ 5; *1999 Cable Attribution Order*, 14 FCC Rcd at 19054 ¶ 104. These stricter attribution standards are also referred to as "program access" attribution standards. *1999 Cable Attribution Order*, 14 FCC Rcd at 19051 ¶ 93.

[26] *1993 Second Report and Order*, 8 FCC Rcd at 8580-81 ¶ 34. *See* former 47 C.F.R. § 73.3555 Note 2(b); former 47 C.F.R. § 76.501Note 2(b). For passive institutional investors, voting stock interests of 10% or more were attributable. *See* former 47 C.F.R. § 76.501 Note 2(c).

[27] 47 C.F.R. § 73.3555 Note 2(a) and (f); 47 C.F.R. § 76.501Note 2(a) and (f).

[28] *1998 Cable Attribution NPRM*, 13 FCC Rcd at 12990 ¶ 1; *citing Review of The Commission's Regulations Governing Attribution of Broadcast Interests, Notice of Proposed Rulemaking*, 10 FCC Rcd 3606 (1995); *Review of The Commission's Regulations Governing Attribution of Broadcast and Cable/MDS Interests, Further Notice of Proposed Rulemaking*, 11 FCC Rcd 19895 (1996).

[29] *See 1999 Cable Attribution Order*, 14 FCC Rcd at 19039-41, 19046 ¶¶ 61-64, 81. Under the original ILP exemption, a limited partner could not be materially involved in the "media activities" of the partnership and retain insulation. *See* former 47 C.F.R. § 76.501 Note 2(f).

[30] *1999 Cable Attribution Order*, 14 FCC Rcd at 19039-40 ¶ 61.

limited partner.[31] The Commission also indicated that a limited partner's insulation would be lost if an agreement for the sale of programming was entered into between the limited partner and the partnership.[32]

6. The United States Court of Appeals for the District of Columbia Circuit in *Time Warner Entertainment Co. v. FCC* (*Time Warner II*) reversed and remanded the Commission's 30% horizontal ownership limit and its 40% channel occupancy limit.[33] Additionally, the court vacated the Commission's decision to eliminate the single majority shareholder exemption to its general cable attribution rules and the "no sale" aspect of the limited partnership insulation criteria.[34] The court found that the horizontal and vertical ownership limits unduly burdened cable operators' First Amendment rights, that the Commission's evidentiary basis for imposing the ownership limits and its rationales supporting the vacated attribution rules did not meet the applicable standards of review, and that the Commission had failed to consider sufficiently changes that have occurred in the MVPD market since passage of the 1992 Act.[35] In response, the Commission issued a Further Notice of Proposed Rulemaking (*2001 Further Notice*).[36]

7. In the *2001 Further Notice*, the Commission solicited comment on the nature of the MVPD industry, industry changes since the 1992 Cable Act, how these changes affected the implementation of horizontal and vertical limits, and various proposals for a new horizontal limit. The Commission sought to develop an evidentiary basis for setting limits, sought to establish the need for vertical limits and their optimal level, and sought comment and evidence on the attribution rules

[31] *See 1999 Cable Attribution Order*, 14 FCC Rcd at 19039-41 ¶¶ 61-64; *Applications for Consent to the Transfer of Control of Licenses and Section 214 Authorizations from MediaOne Group, Inc., Transferor, to AT&T Corp., Transferee*, (*AT&T-MediaOne Order*) 15 FCC Rcd 9816, 9839 ¶ 45 (2000).

[32] *See 1999 Cable Attribution Order*, 14 FCC Rcd at 19055 ¶ 106.

[33] 240 F.3d 1126 (D.C. Cir. 2001) (*Time Warner II*). The D.C. Circuit upheld the underlying statute in *Time Warner Entertainment Co. v. United States*, 211 F.3d 1313 (D.C. Cir. 2000) (*Time Warner I*).

[34] *Time Warner II*, 240 F.3d at 1142-43.

[35] *Id.* at 1130-40. The cable ownership rules were not vacated by the court in *Time Warner II*. In addition, as the court noted, the Commission's voluntary stay of enforcement of the horizontal limit "ended automatically" upon the reversal of the District Court's decision in *Daniels Cablevision, Inc. v. United States*, 835 F.Supp. 1 (D.D.C. 1993) (*Daniels*). *Time Warner II*, 240 F.3d at 1128. The cable horizontal ownership cap has been reversed and remanded, and we have not yet determined what rules will best effectuate Congress' intent in enacting section 613(f) of the Communications Act. If presented with a proposed merger or other transaction involving a cable operator that called into question compliance with our rules during the pendency of this rulemaking, we remain obligated to ensure that the resulting firm's national subscriber reach would not result in the harms to competition and consumers that the horizontal cap is intended to prevent (*i.e.*, ensuring that no cable operator can unfairly impede the flow of video programming from the programmer to the consumer).

[36] *Implementation of Section 11 of the Cable Television Consumer Protection and Competition Act of 1992*, 16 FCC Rcd 17312 (2001) (*2001 Further Notice*). After the *2001 Further Notice*, the Commission suspended the elimination of the broadcast single majority shareholder exemption pending the outcome of this proceeding. *See Review of The Commission's Regulations Governing Attribution of Broadcast and Cable/MDS Interests, Order*, 16 FCC Rcd 22310 (2001).

addressed by the court.[37] The Commission also sought information concerning the contractual relationships between programmers and cable operators in order to establish the extent of cable operators' market power and the effects of market power on the quantity and quality of programming, as well as the effects of market power on the programming costs of smaller MVPDs.[38] Further, the Commission sought comment on consumers' access to alternative MVPDs, particularly Direct Broadcast Satellite (DBS), and their effect on competition in the MVPD market.[39]

8. The *2001 Further Notice* also asked commenters to address, with empirical and/or theoretical evidence, the single majority shareholder exemption and application of the limited partnership insulation criteria to bar programming sales, and, in light of the *Time Warner II* decision, also sought evidence on whether to reinstate the single majority shareholder exemption for purposes of the broadcast and cable/multipoint distribution service (MDS) attribution rules.[40] The Commission is currently reviewing these issues and expects to address expeditiously the broadcast and cable single majority shareholder exemption and the cable limited partnership insulation criteria. This *Second Further Notice of Proposed Rulemaking* (*Second Further Notice*) seeks updated and more specific comment on the Commission's remanded cable horizontal and vertical ownership limits.

9. Commenters to the *2001 Further Notice*[41] offered a range of viewpoints on the ownership questions, arguing at one end of the spectrum that the horizontal cap should remain at 30% or be lowered,[42] and proposing at the other end that the cap be eliminated.[43] Other commenters advocated using a case-by-case approach[44] or a local market-by-market approach.[45] However, none of the comments yielded a sound evidentiary basis for setting horizontal or vertical limits as demanded by the D.C. Circuit. While many commenters presented theoretical, legal or economic arguments and anecdotal evidence, no party provided a compelling approach that supported a particular horizontal or vertical limit. As discussed in detail below, the economic analyses submitted are informative, but not dispositive – we find that they are either unconvincing in light of current marketplace conditions or are simply generalized economic theories that do not provide a sound evidentiary basis for adopting a particular limit. The

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[37] *2001 Further Notice*, 16 FCC Rcd at 17320-21 ¶ 7.

[38] *Id.* at 17316-34 ¶¶ 2-45; 17338-47 ¶¶ 50-73; 17349-52 ¶¶ 76-84.

[39] *Id.* at 17325-28 ¶¶ 18-26; *see also Time Warner II*, 240 F.3d at 1133-34.

[40] *Id.* at 17355 ¶ 87. In 2004, MDS/MMDS was renamed the Broadband Radio Service (BRS) by the Commission. *See Amendment of Part 1, 21, 73, 74 and 101 of the Commission's Rules to Facilitate the Provision of Fixed and Mobile Broadband Access, Educational and Other Advanced Services in the 2150-2162 and 2500-2690 MHz Bands, et al.*, 19 FCC Rcd 14165, 14227-32 ¶¶ 165-76 (2004).

[41] Appendix A provides a list of commenters and the abbreviations by which they are identified herein.

[42] CFA Comments at 25.

[43] Time Warner Comments at 9.

[44] *See, e.g.*, Letter from Michael H. Hammer, Willkie, Farr & Gallagher, on behalf of Comcast, to Marlene H. Dortch, Secretary, FCC (Mar. 13, 2003).

[45] RCN Comments at 18.

passage of time since this record closed gives us additional reason to provide interested parties the opportunity to both augment and refresh the evidentiary record.

10. In addition, the Commission subsequently sought to augment the record by means of a programming network survey and an experimental economics analysis. The Commission's efforts to obtain empirical data and information through the programming network survey yielded little useful information.[46] The Commission then conducted, and released for comment, an experimental economics analysis designed to determine whether changes in concentration may impede the flow of programming to consumers (BKS Study),[47] and developed theoretical analyses designed to determine the relationship between bargaining power and buyer size in a bilateral bargaining environment.[48] The BKS Study created an experimental market that included many of the features of the actual market in which MVPDs and cable programming networks negotiate affiliate fees (*e.g.*, trades involving differentiated products, differences in the level of non-avoidable sunk costs incurred by buyers and sellers, and the use of a sequential bilateral bargaining process to negotiate fees). The study found that increasing horizontal concentration could impede the flow of programming and, by at least one measure, indicated that impairment would be likely to occur at a level of concentration somewhere between a 44% and a 51% market share.[49] The impairment could cause networks to cease operation or reduce the quality of programming delivered to consumers. However, the BKS Study did not model some potentially important aspects of the industry (*i.e.*, vertical integration, retail competition from DBS, entry into and exit from the cable network programming industry, differences in Most Favored Nation (MFN) agreements across different-sized buyers). Similarly, the theoretical work of Adilov and Alexander suggests that, under certain conditions, increased firm size can produce an improved bargaining position and adversely affect the flow of programming.[50] While these analyses of bargaining power show that increasing horizontal size imparts increased bargaining power to the largest buyer of programming, they are imprecise in determining the point at which such increased bargaining power impedes the flow of programming.

11. In addition to the deficiencies in the record, a number of significant events have occurred since the release of the *2001 Further Notice* that must be taken into account in fashioning cable ownership limits. First, the 2002 Comcast-AT&T cable transaction resulted in one entity having a share

[46] *See* Letter from W. Kenneth Ferree, Chief, Cable Services Bureau, FCC, to Programming Network Owners (Feb. 15, 2002). The letter sought information from programming network owners for each network in which they had an interest, including the number of subscribers at the time the network became profitable, the number of subscribers at the end of calendar years 1997-2001, and information on the vertical integration status and genre of each network.

[47] Mark Bykowsky, Anthony Kwasnica, & William Sharkey, *Horizontal Concentration in the Cable Television Industry: An Experimental Analysis*, FCC Office of Plans and Policy, Working Paper No. 35 (June 2002 & rev. July 2002) (*BKS Study*). The BKS Study was released for public comment and generated a substantial record in response.

[48] Nodir Adilov & Peter J. Alexander, *Asymmetric Bargaining Power and Pivotal Buyers*, FCC Media Bureau Working Paper No. 13 (Sept. 2002) (*Asymmetric Bargaining Power*); Nodir Adilov & Peter J. Alexander, *Most-Favored Customers in the Cable Industry*, FCC Media Bureau Working Paper No. 14 (Sept. 2002).

[49] *See* ¶¶ 101-102, *infra*.

[50] *Asymmetric Bargaining Power, supra* n.48.

of MVPD subscribers very close to our remanded 30% ownership limit.[51] Second, the 2003 News Corp.-Hughes transaction created the first vertically integrated DBS operator, involving a number of video programming assets.[52] Third, courts have remanded media ownership rules in three decisions, requiring that the Commission more firmly base its rules on empirical data and record evidence.

12. In 2002, two of the Commission's broadcast ownership rules were reviewed and remanded by the D.C. Circuit in *Fox Television Stations, Inc. v. FCC* and *Sinclair Broadcasting Group, Inc. v. FCC*.[53] While the court in *Fox* agreed that, "[i]n the context of the regulation of broadcasting, 'the public interest' has historically embraced diversity (as well as localism)," it found that the Commission had "not provide[d] an adequate basis for believing the Rule would in fact further" those interests.[54] Similarly, while the court in *Sinclair* found that the Commission had "adequately explained how the local ownership rule furthers diversity at the local level and is necessary in the 'public interest' under §202(h) of the 1996 Act," it remanded the rule, finding that the Commission had "not provided any justification for counting fewer types of 'voices' in the local [television] ownership rules than it counted in its rule on cross-ownership of radio and television stations."[55]

13. In June 2003, the Commission adopted substantial revisions to its broadcast ownership rules in the *Biennial Review Order*.[56] We replaced the newspaper/broadcast and radio/television cross-ownership rules with a set of cross-media limits; modified the local television multiple ownership rule; modified the local radio ownership rule and its market definition; modified the national television ownership rule; and retained the dual network rule.[57] In 2004, in *Prometheus Radio Project, et al. v.*

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[51] *See Applications for Consent to the Transfer of Control of Licenses, Comcast Corporation and AT&T Corp., Transferors, to AT&T Comcast Corporation, Transferee* (*Comcast-AT&T Order*), 17 FCC Rcd 23246 (2002).

[52] *See General Motors Corporation and Hughes Electronics Corporation, Transferors and The News Corporation Limited, Transferee, For Authority to Transfer Control* (*News-Hughes Order*), 19 FCC Rcd 473 (2003). The programming assets involved in the transaction included 35 owned and operated (O&O) full-power television broadcast stations, a national television broadcast network, ten national cable programming networks, and 22 regional cable programming networks.

[53] *See Fox Television Stations, Inc. v. FCC*, 280 F.3d 1027, *modified on rehearing*, 293 F.3d 537 (D.C. Cir. 2002) (*Fox*) and *Sinclair Broadcasting Group, Inc. v. FCC*, 284 F.3d 148 (D.C. Cir. 2002) (*Sinclair*). The court in *Fox* remanded the Commission's retention of the then congressionally-established 35% national television ownership rule. *See 1998 Biennial Review – Review of the Commission's Broadcast Ownership Rules and Other Rules Adopted Pursuant to Section 202 of the Telecommunications Act of 1996*, 15 FCC Rcd 11058 (2000). The court in *Sinclair* remanded the Commission's 1999 revision of its local television multiple ownership rule. *See Review of the Commission's Regulations Governing Television Broadcasting*, 14 FCC Rcd 12903 (1999).

[54] *Fox*, 280 F.3d at 1042, 1043.

[55] *Sinclair*, 284 F.3d at 160, 162.

[56] *2002 Biennial Regulatory Review – Review of the Commission's Broadcast Ownership Rules and Other Rules Adopted Pursuant to Section 202 of the Telecommunications Act of 1996*, 18 FCC Rcd 13620 (2003) (*2002 Biennial Review Order*). *See also* Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996).

[57] *Id.* Congress subsequently amended Section 202(c) of the Telecommunications Act of 1996, directing the Commission to modify the national television ownership limit, contained in 47 C.F.R. § 73.3555, to 39%. See Consolidated Appropriations Act, 2004, Pub. L. No. 108-199, §. 629, 118 Stat. 3 (2004).

FCC (*Prometheus*), the Third Circuit remanded the cross-media limits, the local television multiple ownership rule, and the local radio ownership rule, finding them inadequately justified.[58] The court held that "[d]eference to the Commission's judgment is highest when assessing the rationality of the agency's line-drawing endeavors,"[59] but then directed the Commission to better explain its conclusions.[60]

14. These court decisions are instructive as we attempt to fashion cable horizontal and vertical ownership limits. The *Fox*, *Sinclair*, *Prometheus*, and *Time Warner II* courts all remanded ownership limits under consideration with instructions for the Commission to better justify its decisions on the basis of the record evidence.[61] Each proceeding involved line-drawing determinations to establish ownership limits, and in each the Commission attempted to create rules that would promote policy goals that inherently are not easily measured or quantified. The broadcast ownership proceedings involved an assessment of the continued public interest need for national and local broadcast ownership limits, including local cross-media ownership restrictions applicable to local broadcast television, radio, and newspaper outlets. In setting these limits, the Commission sought to demonstrate how its decisions would promote diversity and localism, as well as competition, based on a wide array of empirical and theoretical evidence.

15. In the cable ownership realm, the Commission is directed by statute to promote effective competition and ensure diversity.[62] Specifically, we must determine at what point cable horizontal reach will unfairly impede the flow of programming, a somewhat fluid concept susceptible to a variety of interpretations, and our vertical limit must be designed to achieve the statutory goals by means of a channel occupancy limit – the mechanism specified by Congress for this purpose.[63] Although courts and agencies routinely attempt to measure and quantify competition, our task in this proceeding is complicated by the possibility that the harms our rules are designed to prevent may arise at concentration levels higher than those that exist in today's markets. As we explain in more detail below, in examining a variety of economic theories of harm relevant to cable ownership limits, it has been difficult to ascertain how hypothetical market conditions might affect competition and diversity. In the face of these difficulties, *Fox*, *Sinclair*, *Prometheus*, and *Time Warner II* instruct us to draw a reasoned and specific connection between the record evidence and each element of our horizontal and vertical ownership limits, a task we cannot adequately accomplish on the basis of the record compiled in response to the *2001 Further Notice*.

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[58] *See Prometheus Radio Project, et al. v. FCC*, 373 F.3d 372 (3rd Cir. 2004) (*Prometheus*). The court found that "[b]ecause the Commission is under a statutory directive to modify the national television ownership cap to 39%, challenges to the Commission's decision to raise the cap to 45% cap are moot." *Id.* at 396.

[59] *Id.* at 410-11 (citations omitted).

[60] *Id.* at 435. The court "identified several provisions in which the Commission falls short of its obligation to justify its decisions to retain, repeal, or modify its media ownership regulations with reasoned analysis." *Id.*

[61] *Fox*, 280 F.3d at 1044; *Sinclair*, 284 F.3d at 169; *Prometheus*, 373 F.3d at 390; *Time Warner II*, 240 F.3d at 1128.

[62] *See* 47 U.S.C. § 533(f)(1).

[63] *See* 47 U.S.C. § 533(f)(1)(A) and (B).

16. We therefore conclude that a *Second Further Notice* is necessary to update the record and provide additional input on horizontal and vertical ownership limits so that we may comply with our statutory mandate and the court's directives in *Time Warner II*. We seek comment on the proposals in the record, recent developments in the industry, and our tentative conclusions described below. We ask commenters to supplement the record where possible by providing new evidence and information to support the formulation of horizontal and vertical limits, and we invite parties to undertake their own studies in order to further inform the record. We also invite comment on Media Bureau Staff Research Paper No. 2004-1 which examines the effect of subscribership on a network's ability to survive in the marketplace.[64] Once the record in this *Second Further Notice* is complete, we intend to expeditiously address the issues contained therein, and enact sustainable cable horizontal and vertical ownership limits.

II. SECOND FURTHER NOTICE OF PROPOSED RULEMAKING

17. As stated above, in 1992, Congress enacted Section 613(f) of the Communications Act to address its concern that the trend towards horizontal and vertical concentration in the cable industry could affect and potentially impede the flow of programming to consumers due to cable operators' size and market power. One goal of the *2001 Further Notice* was to solicit public comment and develop an evidentiary basis for setting horizontal and vertical limits in the current dynamic and evolving communications marketplace. Unfortunately, as previously noted, the record developed thus far does not contain sufficient evidence that would allow us to set reasonable and sustainable horizontal and vertical ownership limits. This *Second Further Notice* is therefore necessary to update the record and provide additional input on ownership limits so that we may comply with our statutory mandate and the court's directives in *Time Warner II*. We retain the original record in this proceeding, and commenters should therefore avoid merely repeating their previously filed comments. Instead, commenters should address how recent developments in the industry may affect our analysis, and provide, where available, new evidence and information to support the formulation of horizontal and vertical limits. Additionally, to develop a more focused and useful record, in this *Second Further Notice*, we address the viability of proposals for setting limits suggested in the record.

A. Legal Framework

1. Statutory Objectives

18. In 1992, Congress recognized that cable operators' increasing horizontal concentration and vertical integration could frustrate competition in the production and delivery of multichannel video programming.[65] Specifically, the Senate Report concluded that increased horizontal concentration could "give cable operators the power to demand that programmers . . . [provide] cable operators an exclusive

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[64] Keith S. Brown, *A Survival Analysis of Cable Networks*, Media Bureau Staff Research Paper No. 2004-1 (rel. Dec. 7, 2004) (Survival Analysis). The Survival Analysis uses the statistical tools of survival and duration analysis to estimate how different variables affect a cable network's probability of survival and expected length of life. Using these results, the study estimates the number of subscribers a cable network needs for any given probability of survival over a given length of time. The Survival Analysis concludes, for example, that a network growing at an average rate requires approximately 42 million subscribers to have a 70% probability of survival over its first 10 years. The study is being placed in the record of this proceeding concurrently with the release of the *Second Further Notice*.

[65] *Senate Report* at 24.

right to carry the programming, a financial interest or some other added consideration as a condition of carriage."[66] More generally, the Senate Report stated, "a market that is dominated by one buyer of a product, a monopsonist, does not give the seller any of the benefits of competition."[67] Congress was also concerned that an increase in vertical integration between cable operators and programmers may provide incentives and opportunities for cable operators to favor affiliated over non-affiliated programmers.[68]

19. A principal objective of the 1992 Act was to foster competition in the acquisition and delivery of multi-channel video programming by encouraging the development of alternative and new technologies, including cable and non-cable systems.[69] Congress evidenced a preference for competition over regulation in order to achieve this objective, believing that the presence of alternative cable and non-cable MVPDs would constrain cable operators' market power in the acquisition and distribution of multi-channel video programming,[70] as well as improve their service and programming quality and curb their subscription rate increases.[71] As detailed below, however, Congress found that the cable industry, the nation's dominant and increasingly horizontally concentrated medium for the delivery of multi-channel programming, faced virtually no competition at the local level, and only limited competition at the regional and national level.[72] Additionally, Congress found that the increase in vertical integration between cable operators and programmers provided incentives and opportunities for cable operators to favor affiliated over non-affiliated programmers and, likewise, for programmers to favor affiliated over

[66] *Id.*

[67] *Id.* at 33 ("Witnesses . . . testified that, with the increased concentration in the cable industry, the large MSOs have the market power to determine what programming services can 'make it' on cable.").

[68] *Id.* at 24; *see also* 1992 Act §§ 2(a)(5)-(6); *House Report* at 41.

[69] *See generally Senate Report, House Report*; *see also* 1992 Act §§ 2(b)(1)-(5).

[70] *See Senate Report* at 12, 18, 20-24; *House Report* at 30, 44; *see also Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, CS Docket No. 00-132, 7th Annual Report, 16 FCC Rcd 6005, 6007 n.4 (2001) (the 1992 Act "imposed a regulatory scheme on the cable industry designed to serve as a transitional mechanism until competition develops and consumers have adequate multi-channel video programming alternatives"). In fact, experience has shown that competition does result in lower rates, improved service, and increased programming fare. *Id.* at 6092-98 ¶¶ 213-34.

[71] Various provisions of the 1992 Act reflect congressional concern "about concentration of the media in the hands of a few who may control the dissemination of information" at the local, regional and national levels. *Senate Report* at 32. *See, e.g.*, 47 U.S.C. § 543(b)(1) (requiring the Commission to issue rules to protect subscribers of "any cable system that is not subject to effective competition" from excessive rates); 47 U.S.C. § 541(a)(1) (prohibiting local authorities from granting exclusive franchises or unreasonably refusing to award additional franchises); 47 U.S.C. § 533(a)(2) (limiting cable operators from owning MMDS or SMATV systems within their franchise areas); 47 U.S.C. § 533(d) (allowing local authorities to deny transfers of franchises that would reduce or eliminate competition in the delivery of cable services); 47 U.S.C. § 544(b)(2)(C) (requiring the Commission to issue rules that promote the commercial availability of cable consumer equipment); 47 U.S.C. § 547(b) (prohibiting cable operators from engaging in unfair practices *vis-à-vis* video programmers and other MVPDs).

[72] *See* 1992 Act §§ 2(a)(2)-(4), (6); *see also Senate Report* at 12, 13-18, 20, 32-34; *House Report* at 27, 43-47.

non-affiliated operators in the distribution of video programming.[73] Thus, given the absence of competition at the time, Congress believed that certain structural limits were necessary.[74]

20. To combat these harms, Section 613(f)(1) of the Communications Act directs the Commission, "in order to enhance effective competition," to conduct proceedings and to set a reasonable horizontal limit "on the number of cable subscribers a person is authorized to reach through cable systems owned by such person, or in which such person has an attributable interest," and a reasonable vertical limit "on the number of channels on a cable system that can be occupied by a video programmer in which the cable operator has an attributable interest."[75] Section 613(f)(2) directs that, in setting these limits, "the Commission shall, among other public interest objectives:"

> (A) ensure that no cable operator or group of cable operators can unfairly impede, either because of the size of any individual operator or because of joint actions by a group of operators of sufficient size, the flow of video programming from the video programmer to the consumer;
>
> (B) ensure that cable operators affiliated with video programmers do not favor such programmers in determining carriage on their cable systems or do not unreasonably restrict the flow of the video programming of such programmers to other video distributors;
>
> (C) take particular account of the market structure, ownership patterns, and other relationships of the cable television industry, including the nature and market power of the local franchise, the joint ownership of cable systems and video programmers, and the various types of non-equity controlling interests;
>
> (D) account for any efficiencies and other benefits that might be gained through increased ownership or control;
>
> (E) make such rules and regulations reflect the dynamic nature of the communications marketplace;
>
> (F) not impose limitations which would bar cable operators from serving previously unserved rural areas; and
>
> (G) not impose limitations which would impair the development of diverse and high quality video programming.[76]

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[73] *See Senate Report* at 24 ("when cable systems are not subject to effective competition . . . [p]rogrammers either deal with operators of such systems on their terms or face the threat of not being carried in that market. The Committee believes this disrupts the crucial relationship between the content provider and the consumer . . . . Moreover, these concerns are exacerbated by the increased vertical integration in the cable industry."); *see also* 1992 Act §§ 2(a)(5)-(6); *House Report* at 41.

[74] *See Senate Report* at 18, 25-26, 33; *House Report* at 26, 30, 40-44.

[75] 47 U.S.C. § 533(f)(1)(A)&(B).

[76] 47 U.S.C. § 533(f)(2)(A)-(G).

2. Judicial Review and Previous Implementation Efforts

21. *Facial Challenge.* Section 613(f) ultimately survived the cable industry's challenge that horizontal and vertical limits violate cable operators' First Amendment rights by excessively limiting their speech.[77] In 2000, the *Time Warner I* court concluded that Section 613(f) resulted from a fear that an increase in concentration and vertical integration could result in anticompetitive behavior by cable operators toward programming suppliers, as well as toward potential new MVPD entrants. The court accepted these concerns as "well grounded in the evidence and a bit of economic common sense" and found them to be important government interests justifying an infringement of the cable operators' right to free expression.[78]

22. *Horizontal Limit.* In the *1993 Second Report and Order,* the Commission found that a limit of 30% of households passed by all cable operators represented a careful balance between: (1) limiting the possible exertion by a cable operator of excessive market power in the purchase of video programming; and (2) ensuring that cable operators are able to expand and benefit from the economies of size necessary to encourage investment in new video programming technology and the deployment of other advanced technologies.[79] In the *1998 Horizontal Reconsideration Order*, the Commission sought comment on possible revisions of the horizontal ownership rules and the method by which horizontal

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[77] *Time Warner I*, 211 F.3d 1313. This facial challenge was launched in 1993, resulting in a judgment that same year that the horizontal "subscriber limits provision unconstitutionally abridged the First Amendment rights of cable operators," while the vertical channel occupancy provision did not. *See Daniels*, 835 F.Supp. 1. The *Daniels* court also decided that, because "there is substantial ground for difference of opinion" as to the constitutionality of the underlying statute, it would stay its proceedings and the issuance of any relief to the plaintiff's pending appeal. The government appealed the former ruling, while Time Warner appealed the latter. *Time Warner I*, 211 F.3d at 1315. Thereafter, the Commission issued the *1993 Second* Report implementing the challenged provisions, but voluntarily stayed the effective date of its rules pending the appeal in *Daniels*. Time Warner then challenged the cable ownership rules in *Time Warner Entertainment Co., L.P. v. FCC*, No. 94-1035 (D.C. Cir. 1994). The D.C. Circuit consolidated the *Daniels* and *Time Warner* appeals in *Time Warner Entertainment Co., L.P. v. FCC*, 93 F.3d 957 (D.C. Cir. 1996), and held the consolidated appeals in abeyance pending the Commission's decision on petitions for reconsideration. *Id.* at 979-80. In 1998, the Commission issued a *Second Order on Reconsideration and Further Notice of Proposed Rulemaking*, 13 FCC Rcd 14462 (1998), maintaining the 30% horizontal limit and denying a motion to lift the stay on enforcement of the horizontal limit. Once the Commission issued the *Second Order on Reconsideration*, the D.C. Circuit lifted its stay on its consideration of the consolidated *Daniels* and *Time Warner* proceedings, issuing a decision reversing the Daniels decision two years later in *Time Warner I*. In the *Second Order on Reconsideration,* the Commission also continued its stay of the effective date of the horizontal ownership rules pending a decision by the D.C. Circuit on challenges to the ownership rules and Section 613(f). *Id.* at 14492 ¶ 75. Once the *Time Warner I* court upheld the constitutionality of the underlying statute, the Commission's voluntary stay of the effectiveness of its rules ended automatically, and the rules went into effect. *See Time Warner II*, 240 F.3d at 1128. The sequential series of decisions, revisions, and appeals resulted in a seven year delay of appellate resolution of the facial challenge to the constitutionality of the underlying statute and in appellate review of the appropriateness of the Commission's implementation of the statute not being resolved until eight years after release of the *1993 Second Report and Order*, which established the basic horizontal and vertical implementation framework at issue in this proceeding.

[78] *Time Warner I,* 211 F.3d at 1322.

[79] *1993 Second Report and Order*, 8 FCC Rcd at 8569, 8582-84 ¶¶ 8, 37-42. The Commission also stated that it intended to review the horizontal limits every five years in order to determine whether they were still reasonable under new market conditions and continued to meet their policy objectives. *Id.* at 8583 ¶ 40.

ownership is calculated.[80] In the *1999 Cable Ownership Order*, the Commission revised the 30% horizontal limit on households passed by all cable operators to include all cable and non-cable MVPD subscribers in the calculation of the appropriate horizontal market, a change it stated was needed to reflect the growing impact emerging non-cable MVPDs were having on the programming marketplace.[81] Under the revised rule, a horizontal subscriber limit of no more than 30% of MVPD subscribers would be equivalent to a 36.7% limit based on cable subscribership alone. The Commission characterized its action as a "significant relaxation of the rule," that retained the "theoretical underpinnings" of its original 30% limit while taking account of marketplace changes through revision of the definition of the relevant market as all MVPD subscribers.[82] The 30% limit continued to be based on the Commission's underlying theory that cable operators at certain concentration levels, "either by unilateral, independent decisions or by tacit collusion," could effectively prevent programming networks from entering or surviving in the marketplace simply by deciding not to carry a particular network.[83] Analyzing industry data, the Commission estimated that a new cable programming network would need access to 40% of the MVPD subscribers nationwide to be viable.[84] A 30% limit, the Commission reasoned, would allow new programming networks access to a 40% "open field" by ensuring the presence of at least four cable operators in the market, and by preventing the two largest cable operators from garnering more than 60% of the market.[85] In this regard, the Commission explained, "even if two operators, covering 60% of the market, individually or collusively deny carriage to a programming network, the network would still have access to 40% of the market, giving it a reasonable chance of financial viability."[86]

23. The *Time Warner II* court rejected the Commission's approach to calculating the horizontal limit. The court found that the Commission lacked any evidence that cable operators would collude and that it could not simply assume that cable operators would coordinate their behavior in this fashion. The court held that Section 613(f)(1) authorizes the Commission to set a limit that would prevent a "single company" from foreclosing entry of a programming network,[87] but does not authorize the agency to regulate the "legitimate, independent editorial choices of multiple MSOs."[88] Having found that the Commission did not provide an adequate evidentiary basis to assume two operators might engage in joint anticompetitive conduct, the court concluded that the record would support a limit no lower than

[80] 13 FCC Rcd at 14464-65 ¶ 4.

[81] *1999 Cable Ownership Order*, 16 FCC Rcd at 19031 ¶ 37.

[82] *Id.*

[83] *Id.* at 19116 ¶ 43; *see also* ¶ 3, *supra.*

[84] The 40% "open field" was based on the Commission's findings that in order to be viable, a new programming network needs access to approximately 15-20 million subscribers (20% of the market), and that, even with such access, it has only a 50% chance of actually reaching subscribers given tier packaging and consumer preferences. *See 1999 Cable Ownership Order*, 14 FCC Rcd at 19115-18 ¶¶ 40-50.

[85] *Id.*

[86] *Id.* at 19119 ¶ 53.

[87] *Time Warner II*, 240 F.3d at 1131.

[88] *Id.* at 1130-35.

60% using the 40% open field premise.[89] The court also required that in fashioning another limit, we recognize that market power depends not only on market share but on the "*availability* of competition."[90]

24. *Vertical Limit.* In the *1993 Second Report and Order*, the Commission adopted a channel occupancy limit that prohibited a cable operator from carrying video programming services it owns or in which it has an attributable interest on more than 40% of its activated channels.[91] In setting the vertical ownership limit at 40%, the Commission sought to "maximize the number of voices available to cable viewers without impairing the ability or incentive of cable operators to invest in new and existing video programming services."[92] The Commission recognized that, although Section 613(f) contemplated the establishment of some limits on cable vertical integration, "MSO investment was responsible for the development and survival of several of the most popular video programming services," and that "vertical integration among the largest MSOs had contributed to program diversity by providing new programming services with an extensive subscriber base and information regarding viewer tastes and desires."[93] The Commission also recognized that vertical integration can produce efficiencies with respect to video programming acquisition, distribution and marketing, which might contribute to innovative programming fare and lower subscription charges.[94] The Commission believed that the 40% limit was "high enough to preserve the benefits of vertical integration,"[95] and further relied upon the fact that most cable operators who filed comments in the rulemaking proceeding supported the 40% limit.[96]

25. The Commission recognized that the need for a vertical limit would likely decrease as channel capacity increased. Thus, the Commission's rule applies to channel capacity only "up to 75 channels."[97] As a result, for higher capacity systems, the percentage limit is effectively much higher than

[89] *Id.* at 1132-33 (accepting, but not addressing the validity of, the Commission's 40% open field premise). The court also found it unnecessary to reach the issue of whether the record supported the Commission's conclusion that new programmers would need access to an "open field" of 40% of U.S. subscribers. *Id.*

[90] *Id.* at 1134 (emphasis in original).

[91] 47 C.F.R. § 76.504. In calculating a system's capacity, "activated channels" includes all commercial and non-commercial broadcast, public, educational, governmental, and leased access channels carried. *See 1993 Second Report and Order*, 8 FCC Rcd at 8588-89 ¶ 54. The Commission has also defined the term "activated channel" in the digital context. *See Carriage of Digital Television Broadcast Signals, Amendments to Part 76 of the Commission Rules, Implementation of the Satellite Home Viewer Improvement Act of 1999, Local Broadcast Signal Carriage Issues, Application of Network Non-Duplication, Syndicated Exclusivity and Sports Blackout Rules to Satellite Retransmission of Broadcast Signals*, 16 FCC Rcd 2598, 2614-16 ¶¶ 39-41 (2001) (*2001 Digital Must Carry Order*), *Second Report and Order and First Order on Reconsideration*, 20 FCC Rcd 4516 (2005).

[92] *See 1993 Second Report and Order*, 8 FCC Rcd at 8592 ¶ 64.

[93] *Id.* at 8584-85 ¶ 44.

[94] *Id.* at 8593-95 ¶ 68.

[95] *Id.* at 8592-96 ¶¶ 65-71.

[96] *Id.*

[97] 47 C.F.R. § 76.504(b). The 75 channel threshold thus reserves at most 45 channels for unaffiliated programming services (75 x .60 = 45).

40%.[98] Moreover, because future expansion of channel capacity through the use of advanced technologies or the presence of effective competition might reduce the need for the limit or render it unnecessary, the Commission stated that it would revisit the restriction at a later date.[99] In this regard, the Commission observed that "Congress has . . . indicated that a primary objective of the Act was to 'rely on the marketplace, to the maximum extent feasible, to promote the availability to the public of a diversity of views and information' and that the legislation was intended to protect consumer interests in the receipt of cable service 'where cable television systems are not subject to effective competition.' Thus . . . further analysis as to whether the restrictions might be phased out where effective competition develops will be appropriate."[100] In the *1995 Vertical Reconsideration Order*, the Commission reaffirmed the vertical limit, barring cable operators with 75 or fewer channels from devoting more than 40% of channel capacity to affiliated programming.[101] It again found that the 40% limit "is appropriate to balance the goals of increasing diversity and reducing the incentive and ability of vertically integrated cable operators to favor their affiliated programming, with the benefits and efficiencies associated with vertical integration."[102] The Commission found that until cable operators deployed emerging technologies such as fiber optic cable or digital signal compression, which would greatly expand channel capacities and thus obviate the need for channel occupancy limits as a means of encouraging cable operators to carry unaffiliated programming, the 75 channel maximum continued to make sense.[103]

26. The *Time Warner II* court concluded that the Commission had not attempted to link the 40% limit with the benefits and harms resulting from common control of both programming supply and distribution sources or with current MVPD market conditions.[104] The court dismissed the Commission's argument that "no MSO has yet complained that the 40% vertical limit has required it to alter programming,"[105] stating this "says nothing about the plans that the rule may have scuttled."[106] Concluding that the Commission neither justified the vertical limit with record support, nor established that the limit did not burden speech more than necessary, the court reversed and remanded the limit. The court cautioned the Commission, on remand, to consider the constraining impact of competition on cable operators' ability to favor affiliated programming at the expense of unaffiliated programming, opining that competition "precludes cable operators from exercising the market power which originally justified channel occupancy limits."[107]

[98] For example, for a 200-channel system, 45 channels must be reserved for unaffiliated programming, and 155 channels, *i.e.*, 85%, could be occupied by operator-affiliated programming.

[99] *1993 Second Report and Order*, 8 FCC Rcd at 8601-02 ¶¶ 83-84.

[100] *Id.* at 8603-04 ¶ 84.

[101] *1995 Vertical Reconsideration Order*, 10 FCC Rcd at 7365 ¶ 3.

[102] *Id.* at 7367 ¶ 8.

[103] *Id.*

[104] *Time Warner II*, 240 F.3d at 1137-38.

[105] *Id.* at 1137.

[106] *Id.* at 1137-38.

[107] *Id.* at 1138.

3. Elements of the Horizontal and Vertical Limits

27. We next examine the stated objectives of Section 613(f) in light of the *Time Warner I* and *Time Warner II* decisions and the comments received in response to the *2001 Further Notice* on the elements of the statute. Section 613(f)(1) of the Communications Act directs the Commission to set horizontal and vertical limits in order to "enhance effective competition."[108] Section 613(f)(2) sets forth seven specific criteria and public interest objectives to be taken into account in setting horizontal and vertical limits.[109] These include consideration of offsetting efficiencies gained through ownership and control and establishment of limits that reflect "the dynamic nature of the communications marketplace."[110] Effectuating Congress' intent under this statute therefore involves a careful weighing of statutory objectives and factors in light of an MVPD marketplace that is rapidly evolving in terms of both distribution platforms and vastly expanded programming choices.

28. *Enhance Effective Competition*. Prefacing the statutory directive to establish both horizontal and vertical cable ownership limits is the single phrase "[i]n order to enhance effective competition."[111] The *2001 Further Notice* discussed changes in the MVPD marketplace and assumed that non-cable MVPDs and overbuilders should be considered "competition" for this purpose since they provide outlets for programmers and alternatives for consumers.[112] The *2001 Further Notice* observed that perhaps "the most important difference between the industry in 1992 and today is that in 1992 there was no clear nationwide substitute for cable," whereas today, "DBS has a national footprint and, although there are questions concerning DBS' ability to constrain cable prices, it appears that DBS currently offers an effective alternative path through which program networks can reach subscribers."[113] At the same time, the Commission recognized that this does not suggest that consumers necessarily enjoy the effects of strong competition in the MVPD market, but rather, simply that there are alternatives to cable available to consumers and programmers which were not available in 1992.[114] In addition, the *2001 Further Notice* observed that in the context of Section 613(f), effective competition "seems to mean competition sufficient to provide alternative means for programmers viably to reach consumers, thus protecting consumer choice and welfare."[115] Comment was sought on the impact of the competitive presence of DBS on cable operators' market power generally and on their ability to select programming

[108] 47 U.S.C. § 533(f)(1).

[109] *See* 47 U.S.C. § 533(f)(2)(A)-(G).

[110] *See* 47 U.S.C. § 533(f)(2)(D), (E).

[111] 47 U.S.C. § 533(f)(1).

[112] *2001 Further Notice*, 16 FCC Rcd at 17327 ¶ 23.

[113] *Id.* at 17326-27 ¶ 22, citing, *2000 Price Survey. See also EchoStar Communications Corporation, General Motors Corporation, Hughes Electronics Corporation (Transferors) and EchoStar Communications Corporation (Transferees)*, 17 FCC Rcd 20559, 20605-09 ¶¶ 106-16 (*EchoStar-DirecTV HDO*) (tentative conclusion that for purposes of initial analyses of EchoStar/DirecTV merger application, relevant product market was MVPD market; issue of whether DBS is in fact a closer substitute for DBS than cable designated for hearing).

[114] *Id.* at 17327 ¶ 24.

[115] *Id.*

for reasons other than quality and/or viewer interest, and on the extent to which advertisers view DBS as an effective substitute for cable in reaching viewers.[116]

29. Comcast contends that cable faces competition in every market because DBS is a clear substitute for cable, noting that 60% of all DBS subscribers are in areas served by cable, and nearly half of all current DBS subscribers are former cable subscribers.[117] Writer's Guild argues that DBS providers are not yet significant enough to compete in the market for the purchase of programming and limit the market power of cable operators, and that DBS will have even less ability to compete if the 30% horizontal ownership cap is lifted.[118] Writer's Guild further contends that the limited reach of DBS and other competitive MVPDs restricts their ability to make a program service viable, and that a new network still cannot be viable without cable carriage.[119] Similarly, CFA argues that satellite remains primarily a niche market player serving either rural communities in which cable is inferior or unavailable or serving high-volume specialty programming markets.[120] Further, CFA cites a Consumers Union Survey that appears to indicate that DBS and cable are viewed differently by consumers and function more as "complements" rather than "substitutes" in the market.[121] CFA also argues that "enhance" requires the Commission to do more than merely protect competition.[122]

30. The record compiled in response to the *2001 Further Notice* is now four years old. Total DBS subscribership has increased during this time from about 16.1 million households to approximately 23.2 million households, a factor that must be taken into account in fashioning rules intended to enhance effective competition.[123] In addition, News Corp.'s acquisition of DirecTV created, for the first time, a DBS operator that is vertically integrated with programming networks. We therefore seek updated evidence and analysis of the role of DBS competition in providing alternative means for programmers to viably reach consumers, thus protecting consumer choice and welfare, and comment on the weight to be given such competition in establishing the ownership limits. We seek comment on how a vertical limit can enhance effective competition if programming rejected by an incumbent cable operator can be carried on an alternative MVPD, or via other means of electronic delivery to the consumer. Additionally, the Commission must consider the extent to which horizontal and vertical limits are intended to promote

[116] *Id.* ¶ 23.

[117] Comcast Reply Comments at 11-13.

[118] Writer's Guild Comments at 9.

[119] *Id.*

[120] CFA Comments at 151-53.

[121] *Id.* at 159-63.

[122] *Id.* at 16. CFA further argues that the antitrust law alone supports a 30% horizontal ownership limit, and that because the antitrust law is intended only to protect, not enhance, competition, the Commission cannot adopt a limit higher than 30%. *Id.* at 25-29, citing *U.S. v. Philadelphia National Bank*, 374 U.S. 270 (1966) and *FTC v. H.J. Heinz Company*, 246 F.3d 708 (DC Cir. 2001).

[123] *See Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, 20 FCC Rcd 2755, 2792-93 ¶ 54 (2005) (*11th Annual Report*). *See also* further discussion on the significant recent growth in DBS subscribership in ¶ 52, *infra*.

competition in the programming market. We tentatively conclude that "enhance effective competition" applies to MVPD competition as well as competition in the supply of programming and seek comment on this tentative conclusion.

31. *Not Unfairly Impede the Flow of Programming.* Section 613(f)(2)(A) requires that the Commission "ensure that no cable operator or group of cable operators can unfairly impede, either because of the size of any individual operator or because of joint actions by a group of operators of sufficient size, the flow of video programming from the video programmer to the consumer."[124] The court in *Time Warner II* held that a broad interpretation of "unfair" "is plausible only for actions that impinge on the interest in competition that lay at the heart of Congress's concern."[125] How should "unfair" be defined after the *Time Warner II* decision? Does "unfairly" suggest that our analysis focus on "efficiency" as used in a purely economic model? Or, should our analysis rely much less on economic concepts, as suggested by AT&T when it argues that if there are at least two outlets and no collusion, a programmer's failure to reach homes is the result of "legitimate, independent editorial choices" and cannot be deemed unfair?[126] We also seek comment on the ability and incentive of an individual cable operator, or group of cable operators, to restrict the flow of programming to the consumer. Is it possible for the "flow of video programming" to be quantified, and if so, what amount must be unfairly impeded before being constrained by an ownership limit? The BKS Study attempted to quantify the level of cable operator concentration where the flow of programming becomes restricted. We seek comment on whether experimental economics studies, other types of studies, economic theory, or experience in other industries would be useful in identifying the point at which horizontal concentration among cable operators is likely to unfairly impede the flow of programming.

32. *Neither Favor Nor Unfairly Restrict Affiliated Programming.* Section 613(f)(2)(B) of the Act directs the Commission to ensure that cable operators affiliated with video programmers "do not favor such programmers in determining carriage" nor "unreasonably restrict" the flow of programming from such programmers to other MVPDs.[127] RCN proposes that the Commission adopt regulations, based on authority in Section 613(f) and its ancillary jurisdiction, that would, on a market-by-market basis, measure market power through an analysis of an entity's ability to control access to "sought-after programming."[128] According to RCN, if MVPD entrants cannot gain access to this programming due to the incumbent's ability to control that programming, then a presumptive finding of market power would be made, which would compel the owner of the programming to make it available on "industry-standard terms." RCN recommends limiting this rule to programming that is "unique and otherwise unobtainable," thus excluding programming that a competitor could produce itself.[129] In contrast, Cablevision argues that the proliferation of unaffiliated networks, the emergence of the broadcast networks as a significant competitive force in the cable programming market, and the strength and

[124] 47 U.S.C. § 533(f)(2)(A).

[125] *Time Warner II*, 240 F.3d at 1135.

[126] AT&T Comments at 13-14, citing *Time Warner II*, 240 F.3d at 1135.

[127] 47 U.S.C. § 533(f)(2)(B).

[128] RCN Comments at 15-18.

[129] *Id.* at 16-17.

durability of competition from alternative MVPDs precludes cable operators from using vertical integration to thwart competition from rival MVPDs and programmers.[130] Cablevision further argues that rival MVPDs have access to a broad range of non-vertically integrated programming, as well as the ability to enter into programming investments themselves.[131] We seek further comment on how ownership limits may further the statutory objective that cable operators not favor affiliated programmers in determining carriage nor "unreasonably restrict" the flow of programming from such programmers to other MVPDs in light of current marketplace conditions. In addition, we seek comment on the types of activity that would constitute an unreasonable restriction on the flow of programming from affiliated programmers to other MVPDs, and how ownership limits could address such activity.

33. *Market Structures; Industry Relationships; Joint Ownership; Nature and Market Power of Local Franchise.* Section 613(f)(2)(C) of the Act directs the Commission to "take particular account of the market structure, ownership patterns, and other relationships of the cable television industry, including the nature and market power of the local franchise, the joint ownership of cable systems and video programmers, and the various types of non-equity controlling interests."[132] In the *2001 Further Notice*, we asked for comment on the existing market structure and ownership patterns in the cable industry.[133] We received no comments on precisely how we should interpret the terms in Section 613(f)(2)(C). Cablevision, however, comments that the Commission should follow the congressional directive to rely on the marketplace "to the maximum extent feasible" when establishing rules under the 1992 Act.[134] We seek comment on the meaning of these statutory terms and their effect with regard to setting effective ownership limits. In particular, do "ownership patterns" and "the nature and market power of the local franchise" refer to clustering, or some other phenomenon? Does "joint ownership of cable systems and video programmers, and the various types of non-equity controlling interests" entail only issues of vertical integration and our attribution rules, or was Congress referring to something more?

34. *Offsetting Benefits and Need for Rules to Reflect Dynamic Marketplace.* In addition to accounting for potential harms that may occur as a result of horizontal concentration and vertical integration, Section 613(f)(2) requires that the Commission "account for any . . . benefits that might be gained through increased ownership or control;[135] make such rules and regulations reflect the dynamic nature of the communications marketplace;[136] and not impose limitations which would bar cable operators from serving previously unserved rural areas.[137] AT&T states that there are clear public interest benefits to increased cable concentration, mostly as the result of cable operators' economies of

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[130] Cablevision Comments at 9.

[131] *Id.* at 9-10, citing, for example, a transaction between EchoStar, Vivendi, and the USA Network.

[132] 47 U.S.C. § 533(f)(2)(C).

[133] *2001 Further Notice*, 16 FCC Rcd at 17334 ¶ 44.

[134] Cablevision Comments at 10-11, citing the 1992 Act, § 2(b)(2).

[135] 47 U.S.C. § 533(f)(2)(D).

[136] 47 U.S.C. § 533(f)(2)(E).

[137] 47 U.S.C. § 533(f)(2)(F).

scale, and that the Commission is required to take such benefits into account.[138] Citing Section 613(f)(2)(E), that the ownership rules must reflect the dynamic nature of the communications marketplace, Progress and Freedom Foundation (PFF) explains that the cable industry's recent evolution from strictly analog video programming to digital video and non-video offerings has made the industry much more dynamic.[139] We seek comment on the effect of these considerations of potential benefits with regard to setting ownership limits.[140]

35. *Rules Not to Impair Development of Diverse and High Quality Programming.* Section 613(f)(2)(G) requires the Commission to ensure that any limits imposed do not "impair the development of diverse and high quality video programming." *Time Warner I* upheld the constitutionality of Section 613(f), finding that Congress reasonably concluded that dramatic concentration in the cable industry "threatened the diversity of information available to the public and could form a barrier to the entry of new cable programmers."[141] In *Time Warner II*, however, the court concluded that "Congress has not given the Commission authority to impose, solely on the basis of the 'diversity' precept, a limit that does more than guarantee a programmer two possible outlets (each of them a market adequate for viability)."[142] Nevertheless, the court suggested that diversity, while not the primary concern of the statute, is a factor entitled to consideration.[143] To fully implement the provisions of Section 613(f), as well as abide by the court's directives in *Time Warner II*, in the *2001 Further Notice*, we asked for comment on the scope of our diversity goal in light of the court's ruling.[144]

36. In response to the *2001 Further Notice*, AT&T argues that Congress' primary concern in authorizing ownership limits is fair competition, while diversity is a "byproduct" of requirements that ensure there are at least two outlets for video programming.[145] Comcast argues that the availability of two conduits through which a programmer could reach the number of viewers needed for viability is the absolute limit on diversity as a justification for horizontal ownership restrictions.[146] CFA argues,

[138] AT&T Comments at 69, citing AT&T Comments, Ordover Decl. at ¶129.

[139] PFF Comments at 9, 12-16.

[140] We further discuss each of these goals in the context of determining horizontal and vertical ownership limits as appropriate in Sections II. C. and D., *infra.*

[141] *Time Warner I*, 211 F.3d at 1320. The court further held that "[i]t is enough that, having determined that '[c]oncentration has grown dramatically in the cable industry,' S. Rep. at 32, 1992 U.S.C.C.A.N. at 1165, the Congress reasonably concluded that this concentration threatened the diversity of information available to the public and could form a barrier to the entry of new cable programmers. That is hardly an unreasonable inference." *Id.*

[142] *Time Warner II*, 240 F.3d at 1135.

[143] *Id.* at 1136, noting "the duality of interests [competition and diversity] at work in this section."

[144] Pursuant to Section 613, our cable horizontal and vertical ownership limits were designed to promote a diversity of programming choices for consumers.

[145] AT&T Comments at 11-12, citing *Time Warner II*, 240 F.3d at 1136.

[146] Comcast Comments at 16.

however, that while the court found that the Commission cannot rely solely on diversity as a rationale for its horizontal ownership limit, diversity remains one of the two primary concerns animating the 1992 Act, and the Commission must act on a prophylactic basis to accomplish the dual goals of competition and diversity.[147] CFA also asserts that the *Time Warner II* decision requires the Commission to: (1) clearly articulate economic and legal rationales supporting its decision; (2) prove that its enhancement of diversity under the rule is substantial rather than de minimis;[148] and (3) recognize that Congress' overarching purpose was to enhance effective competition, which, in turn, protects diversity.[149] RCN argues that despite the court's holding in *Time Warner II*, the Commission has ample authority under Section 613, as well as other sections of the Act, to promulgate rules that promote diversity.[150] We seek comment on the role and weight diversity concerns should play in setting our ownership limits. If our limits ensure adequate competition in the MVPD marketplace such that the flow of programming is not unfairly impeded, would diversity likewise be ensured?

37. We are interested in whether the widespread availability of DBS service, along with its continued strong growth in subscribership since the *2001 Further Notice*, provide an adequate outlet for programming such that diversity is ensured.[151] Writer's Guild argues that DBS operators are not a source of programming diversity, because their limited subscribership restricts their ability to make programming services viable.[152] However, as we noted previously, since the record closed on the *2001 Further Notice,* total DBS subscribership has grown from approximately 16.1 million in June 2001 to 23.2 million in June 2004, an increase of almost 45%.[153] At the same time, it appears that a number of new networks have launched successfully using business models that do not require the same subscriber reach that more established, general interest networks enjoy.[154] In assessing how a limit could promote

[147] CFA Comments at 13-16.

[148] CFA cites to the Commission's Opposition to Certiorari in *Time Warner II*, where we stated: "The court of appeals found the promotion of diversity to be an insufficient justification for the rule because 'at some point . . . the marginal value of such an increment in diversity would not qualify as an important governmental interest' . . . . That concern about *de minimis* enhancements in diversity, however, has no relevance here . . . . The court's ability to imagine hypothetical situations where the incremental increase in diversity might not justify a regulation thus provides no basis for invalidating a regulation whose actual and foreseeable operation substantially enhances the Congressional goal of diversity." *Id.*, citing FCC Opposition to Cert. at 10-11.

[149] *Id.*

[150] RCN argues that the following sections of the Act also apply: Sections 601; 612(a), (e)(2)-(3), (g); and 628(a), (c)(1), (c)(4)(D). RCN Comments at 9.

[151] As of June 2004, DirecTV is the second largest MVPD and EchoStar (DISH Network) is the fourth. *See 11th Annual Report*, 20 FCC Rcd at 2793 ¶ 55.

[152] Writer's Guild Comments at 9.

[153] *See* n.123, *supra.*

[154] For example, College Sports Television, The Tennis Channel, and Reality Central have focused on seeking carriage on cable operators' digital tiers, which generally reach a smaller segment of a cable operator's subscribers. *See* discussion in Section II. B., *infra*. However, Oxygen Network states that carriage on a cable operator's analog tier – providing assurance of widespread distribution – is essential to obtain the financing necessary to develop and launch an independent programming service. *See* Oxygen Comments filed in MB Docket No. 04-207 (*A La Carte Proceeding*) at 3 (Jul. 15, 2004).